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Governmental Accounting Standards Series

Statement No. 91 of the
Governmental Accounting
Standards Board

Conduit Debt Obligations



GOVERNMENTAL ACCOUNTING STANDARDS BOARD
OF THE FINANCIAL ACCOUNTING FOUNDATION

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Summary

The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This Statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures.

A conduit debt obligation is defined as a debt instrument having *all* of the following characteristics:

- There are at least three parties involved: (1) an issuer, (2) a third-party obligor, and (3) a debt holder or a debt trustee.
- The issuer and the third-party obligor are not within the same financial reporting entity.
- The debt obligation is not a parity bond of the issuer, nor is it cross-collateralized with other debt of the issuer.
- The third-party obligor or its agent, not the issuer, ultimately receives the proceeds from the debt issuance.
- The third-party obligor, not the issuer, is primarily obligated for the payment of all amounts associated with the debt obligation (debt service payments).

All conduit debt obligations involve the issuer making a limited commitment. Some issuers extend additional commitments or voluntary commitments to support debt service in the event the third party is, or will be, unable to do so.

An issuer should not recognize a conduit debt obligation as a liability. However, an issuer should recognize a liability associated with an additional commitment or a voluntary commitment to support debt service if certain recognition criteria are met. As long as a conduit debt obligation is outstanding, an issuer that has made an additional commitment should evaluate at least annually whether those criteria are met. An issuer that has made only a limited commitment should evaluate whether those criteria are met when an event occurs that causes the issuer to reevaluate its willingness or ability to support the obligor's debt service through a voluntary commitment.

This Statement also addresses arrangements—often characterized as leases—that are associated with conduit debt obligations. In those arrangements, capital assets are constructed or acquired with the proceeds of a conduit

debt obligation and used by third-party obligors in the course of their activities. Payments from third-party obligors are intended to cover and coincide with debt service payments. During those arrangements, issuers retain the titles to the capital assets. Those titles may or may not pass to the obligors at the end of the arrangements.

Issuers should not report those arrangements as leases, nor should they recognize a liability for the related conduit debt obligations or a receivable for the payments related to those arrangements. In addition, the following provisions apply:

- If the title passes to the third-party obligor at the end of the arrangement, an issuer should not recognize a capital asset.
- If the title does not pass to the third-party obligor and the third party has exclusive use of the entire capital asset during the arrangement, the issuer should not recognize a capital asset until the arrangement ends.
- If the title does not pass to the third-party obligor and the third party has exclusive use of only portions of the capital asset during the arrangement, the issuer, at the inception of the arrangement, should recognize the entire capital asset and a deferred inflow of resources. The deferred inflow of resources should be reduced, and an inflow recognized, in a systematic and rational manner over the term of the arrangement.

This Statement requires issuers to disclose general information about their conduit debt obligations, organized by type of commitment, including the aggregate outstanding principal amount of the issuers' conduit debt obligations and a description of each type of commitment. Issuers that recognize liabilities related to supporting the debt service of conduit debt obligations also should disclose information about the amount recognized and how the liabilities changed during the reporting period.

Effective Date and Transition

The requirements of this Statement are effective for reporting periods beginning after December 15, 2020. Earlier application is encouraged.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will improve financial reporting by eliminating the existing option for issuers to report conduit debt obligations as their own liabilities, thereby ending significant diversity in practice. The clarified definition will resolve stakeholders' uncertainty as to whether a given financing is, in fact, a conduit debt obligation. Requiring issuers to recognize liabilities associated with additional commitments extended by issuers and to recognize assets and deferred inflows of resources related to certain arrangements associated with conduit debt obligations also will eliminate diversity, thereby improving comparability in reporting by issuers. Revised disclosure requirements will provide financial statement users with better information regarding the commitments issuers extend and the likelihood that they will fulfill those commitments. That information will inform users of the potential impact of such commitments on the financial resources of issuers and help users assess issuers' roles in conduit debt obligations.

How the Board Considered Costs and Benefits in the Development of This Statement

One of the principles guiding the Board's setting of standards for accounting and financial reporting is the assessment of expected benefits and perceived costs. The Board strives to determine that its standards address significant user needs and that the costs incurred through the application of its standards, compared with possible alternatives, are justified when compared to the expected overall public benefit. The Board believes that the expected benefits that will result from the information provided through implementation of this Statement—more comparable and consistent accounting and financial reporting, and more relevant, reliable, and understandable information about conduit debt obligations and the commitments and arrangements associated with them—are significant and justify the perceived costs of implementation and ongoing compliance.

This Statement improves the comparability of financial reporting for issuers by eliminating the option to recognize a liability for a conduit debt obligation. Certain decisions made by the Board were intended to provide cost relief. For example, some ongoing costs will be avoided by not requiring an annual evaluation for certain issuers.

Unless otherwise specified, pronouncements of the GASB apply to financial reports of all state and local governmental entities, including general purpose governments; public benefit corporations and authorities; public employee retirement systems; and public utilities, hospitals and other healthcare providers, and colleges and universities. Paragraph 3 discusses the applicability of this Statement.

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Governmental Accounting
Standards Board

Conduit Debt Obligations

May 2019



GOVERNMENTAL ACCOUNTING STANDARDS BOARD

of the Financial Accounting Foundation

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INTRODUCTION

1. To provide financing for specific governmental or nongovernmental third-party obligors, some governments issue conduit debt obligations bearing the government's own name. Debt service payments generally are made by third-party obligors directly to debt trustees or, in private placements, directly to debt holders. In many cases, the issuer assumes no responsibility for debt service payments of a conduit debt obligation beyond the resources provided by the third-party obligor.

2. The objective of this Statement is to better meet the information needs of financial statement users by enhancing the comparability and consistency of conduit debt obligation reporting and reporting of related transactions and other events by state and local government issuers. This Statement also is intended to improve the relevance, reliability, and understandability of information about conduit debt obligations, as well as related transactions and other events.

STANDARDS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING

Scope and Applicability of This Statement

3. This Statement defines conduit debt obligations for accounting and financial reporting purposes and establishes related standards for recognition, measurement, and disclosure for issuers. The requirements of this Statement apply to the financial statements of all state and local governments.

4. If an issuer has extended a financial guarantee associated with a conduit debt obligation, the issuer should apply paragraphs 12–17 and 24–26 of this Statement rather than (a) paragraphs 7–10 and 14–15 of Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, for a nonexchange financial guarantee or (b) paragraphs 100–105 and 109 of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, for an exchange or exchange-like financial guarantee.

5. This Statement supersedes Interpretation No. 2, *Disclosure of Conduit Debt Obligations*, and *Implementation Guide No. 2015-1*, Questions 7.22.14, 7.22.18, and Z.I2.1. This Statement amends NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles*, paragraph 158; NCGA Statement 4, *Accounting and Financial Reporting Principles for Claims and Judgments and Compensated Absences*, paragraph 9; Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, paragraph 3; Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, footnote 48; Statement 62, paragraphs 98, 99, and 109; Statement 70, paragraph 5; Statement No. 79, *Certain External Investment Pools and Pool Participants*, paragraph 31; Statement No. 87, *Leases*, paragraph 8; NCGA Interpretation 6, *Notes to the Financial Statements Disclosure*, paragraphs 4 and 5; and *Implementation Guide 2015-1*, Question 2.27.1.

Definition of a Conduit Debt Obligation

6. For accounting and financial reporting purposes, a conduit debt obligation is a debt instrument issued in the name of a state or local government (the issuer) that is for the benefit of a third party primarily liable for the repayment of the debt instrument (the third-party obligor). A conduit debt obligation has *all* of the following characteristics:

- a. There are at least three parties involved: (1) an issuer, (2) a third-party obligor, and (3) a debt holder or a debt trustee. There may be more than one third-party obligor, debt holder, or debt trustee.
- b. The issuer and the third-party obligor are not within the same financial reporting entity.

- c. The debt obligation is not a parity bond¹ of the issuer, nor is it cross-collateralized with other debt of the issuer.
- d. The third-party obligor or its agent, not the issuer, ultimately receives the proceeds from the debt issuance.
- e. The third-party obligor, not the issuer, is primarily obligated for the payment of all amounts associated with the debt obligation (debt service payments).

Limited, Additional, and Voluntary Commitments Extended by Issuers Associated with Conduit Debt Obligations

7. An issuer of a conduit debt obligation that meets the characteristics in paragraph 6 makes a *limited commitment* to, at a minimum, maintain the issue's tax-exempt status. In a limited commitment, the issuer assumes no responsibility for debt service payments beyond the resources, if any, provided by the third-party obligor. However, the limited commitment also may include facilitating payments from the third-party obligor to the debt holder(s) directly or through an agent.

8. An issuer's commitments associated with a conduit debt obligation can vary. Generally, an issuer's commitment with respect to the conduit debt obligation is limited, as described in paragraph 7. However, the issuer can extend an *additional commitment* or a *voluntary commitment* of its own resources. Under an additional commitment, the issuer agrees to support debt service payments only in the event the third-party obligor is, or will be, unable to do so. Examples of additional commitments by an issuer to support debt service payments include, but are not limited to, the following types:

- a. Extending a moral obligation pledge
- b. Extending an appropriation pledge
- c. Extending a financial guarantee
- d. Pledging its own property, revenue, or other assets as security.

9. Under a voluntary commitment, an issuer does not make an additional commitment but on a voluntary basis decides to make a debt service payment or request an appropriation for a debt service payment in the event that the third party is, or will be, unable to do so.

¹A parity bond is a bond with equal rights to the collateral as other bonds issued under a common bond indenture.

Recognition and Measurement

10. An issuer should not recognize a conduit debt obligation as a liability. An issuer that has not made an additional commitment or a voluntary commitment is not required to perform an annual evaluation to determine whether recognition criteria are met. As long as the conduit debt obligation is outstanding, an issuer that has made an additional commitment (as described in paragraph 8) should evaluate at least annually whether the recognition criteria in paragraphs 12, 13, 16, and 17 are met. If those criteria are met, the issuer should apply the recognition and measurement guidance in paragraphs 12–17.

11. An issuer that has made only a limited commitment (as described in paragraph 7) for a conduit debt obligation should evaluate the likelihood that it will make a debt service payment due to a voluntary commitment (as described in paragraph 9) when there is an event or circumstance that causes the issuer to consider supporting debt service payments for that conduit debt obligation. If an event or circumstance occurs, the issuer should apply the recognition and measurement guidance in paragraphs 13–17 to that conduit debt obligation. In subsequent years, the issuer should reevaluate at least annually whether the recognition criteria in paragraphs 13, 14, 16, and 17 continue to be met for that voluntary commitment. The annual evaluation in subsequent fiscal years is required only for the issue for which a liability was recognized, not the entirety of an issuer's portfolio.

Recognition and Measurement in Financial Statements Prepared Using the Economic Resources Measurement Focus

12. An issuer should recognize a liability associated with an additional commitment to support debt service payments and an expense in financial statements prepared using the economic resources measurement focus if qualitative factors indicate that it is *more likely than not*² that the issuer will support one or more debt service payments for a conduit debt obligation.

²The term *more likely than not* means a likelihood of more than 50 percent.

13. Qualitative factors to assess whether it is more likely than not that an issuer will support one or more debt service payments include, but are not limited to, the following:

- a. A third-party obligor initiating the process of entering into bankruptcy or financial reorganization
- b. A third-party obligor breaching a debt contract in relation to the conduit debt obligation, such as failure to meet rate covenants, failure to meet debt service coverage ratios, or default or delinquency in debt service payments
- c. A third-party obligor experiencing significant financial difficulty, such as failure to make payments to paying agents or trustees on a timely basis; drawing on a reserve fund to make debt service payments; initiation of a process to intercept receipts to make debt service payments; debt holder concessions; significant investment losses; loss of a major revenue source; significant increase in noncapital disbursements in relation to operating or current revenues; or commencement of financial supervision by another government, if the third-party obligor is a government
- d. Termination of the project that was to be the source of funding for debt service payments
- e. Litigation that would negatively affect the project
- f. The issuer's concern that its access to capital markets could be affected by a third-party obligor's default on an outstanding conduit debt obligation
- g. The issuer's history of fulfilling its additional commitments to support debt service payments for other conduit debt obligations, including voluntarily supporting debt service payments
- h. The issuer's ability or willingness to support debt service payments.

14. When an event or circumstance has occurred as described in paragraph 11, an issuer should recognize a liability associated with a voluntary commitment to support debt service payments and an expense in financial statements prepared using the economic resources measurement focus, if qualitative factors described in paragraph 13 indicate that it is more likely than not that the issuer will support one or more debt service payments for a conduit debt obligation.

15. The amount recognized for the liability and expense should be measured as the discounted present value of the best estimate of the future outflows (that is, payments to support debt service) expected to be incurred. If there is no best estimate of the future outflows expected to be incurred but a range of estimated

future outflows can be established in which no amount within that range appears to be a better estimate than any other amount, the discounted present value of the minimum amount in that range should be recognized.

Recognition and Measurement in Financial Statements Prepared Using the Current Financial Resources Measurement Focus

16. An issuer should recognize a fund liability and an expenditure, to the extent that the liability is normally expected to be liquidated with expendable available financial resources, if qualitative factors discussed in paragraph 13 indicate that (a) it is more likely than not that the issuer will support debt service payments associated with an additional commitment or (b) it is more likely than not, after an event or circumstance has occurred as described in paragraph 11, that the issuer will support one or more debt service payments for a conduit debt obligation through a voluntary commitment.

17. A fund liability is normally expected to be liquidated with expendable available financial resources when a payment to support a conduit debt obligation is due and payable.

Arrangements Associated with Conduit Debt Obligations

General Attributes

18. An issuer of conduit debt obligations may enter into arrangements—often characterized as leases—that are associated with conduit debt obligations. Those arrangements have all of the following attributes:

- a. The construction or acquisition of the capital asset is financed with the proceeds from the conduit debt obligation.
- b. The issuer retains the title to the capital asset from the beginning of the arrangement.
- c. The payments from the third-party obligor are to cover the debt service payments.
- d. The payment schedule of the arrangement coincides with the debt service repayment schedule.

19. For an arrangement described in paragraph 18 that does not meet the definition of a service concession arrangement (SCA), an issuer should *not* report the arrangement as a lease, regardless of whether the arrangement is labeled or otherwise referred to as a lease. Some arrangements described in paragraph 18 meet the definition of an SCA in paragraph 4 of Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*. If an arrangement associated with a conduit debt obligation meets the definition of an SCA, the issuer should account for that arrangement as an SCA by applying the accounting and financial reporting requirements in paragraphs 8–12 of Statement 60 rather than paragraphs 20–23 of this Statement. Generally, arrangements described in paragraph 18 other than SCAs can be classified into one of the following three categories and should be recognized consistent with the provisions in paragraphs 20–23.

- a. The issuer relinquishes the title to the capital asset at the end of the arrangement, at which time the conduit debt obligation generally has been paid off. (See paragraph 20.)
- b. The issuer does not relinquish the title to the capital asset. The third-party obligor has exclusive use of the entire capital asset until the end of the arrangement. (See paragraph 21.)
- c. The issuer does not relinquish the title to the capital asset. The third-party obligor has exclusive use of only portions of the capital asset until the end of the arrangement. (See paragraphs 22 and 23.)

Issuer Relinquishes Title at the End of the Arrangement

20. In an arrangement as described in paragraphs 18 and 19a, the issuer should *not* recognize (a) a liability for the conduit debt obligation, (b) the capital asset, or (c) a receivable for the payments related to the arrangement.

Issuer Retains Title and Third-Party Obligor Has Exclusive Use of the Entire Capital Asset

21. In an arrangement as described in paragraphs 18 and 19b, at the inception of the arrangement, the issuer should *not* recognize (a) a liability for the conduit debt obligation, (b) the capital asset, or (c) a receivable for the payments related to the arrangement. When the arrangement ends, the issuer should recognize the capital asset at *acquisition value*, as defined in paragraph 79 of Statement No. 72, *Fair Value Measurement and Application*, and an inflow of resources.

Issuer Retains Title and Third-Party Obligor Has Exclusive Use of Portions of the Capital Asset

22. In an arrangement as described in paragraphs 18 and 19c, the issuer, at the inception of the arrangement, should recognize the entire capital asset (rather than only the portions of the asset for which the third-party obligor has nonexclusive use) at acquisition value. The issuer should *not* recognize either (a) a liability for the conduit debt obligation or (b) a receivable for the payments related to the arrangement.

23. In that arrangement, when the issuer recognizes the capital asset, the issuer also should recognize a deferred inflow of resources for the same amount. The deferred inflow of resources should be reduced, and an inflow of resources should be recognized in a systematic and rational manner over the term of the arrangement.

Notes to Financial Statements

24. An issuer should disclose the information in paragraphs 25 and 26 about conduit debt obligations in the notes to financial statements.

25. The disclosures of conduit debt obligations should include:

- a. A general description of the issuer's conduit debt obligation(s)
- b. A general description of the issuer's limited commitment(s)
- c. A general description of the issuer's voluntary commitment(s)
- d. A general description of the issuer's additional commitment(s), including:
 - (1) The legal authority and limits for extending the commitment(s)
 - (2) The length of time of the commitment(s)
 - (3) Arrangements, if any, for recovering payments from the third-party obligor(s)
- e. The aggregate outstanding principal amount of all conduit debt obligations that share the same type of commitment(s) at the end of the reporting period.

26. If an issuer has recognized a liability in accordance with paragraphs 10–17, it should disclose the following information:

- a. A brief description of the timing of recognition and measurement of the liability and information about the changes in the recognized liability, including the following:
 - (1) Beginning-of-period balances
 - (2) Increases, including initial recognition and adjustments increasing estimates
 - (3) Decreases, including payments made and adjustments decreasing estimates
 - (4) End-of-period balances
- b. Cumulative amounts of payments that have been made on the recognized liability at the reporting date, if any
- c. Amounts expected to be recovered from those payments, if any.

EFFECTIVE DATE AND TRANSITION

27. The requirements of this Statement are effective for reporting periods beginning after December 15, 2020. Earlier application is encouraged.

28. Changes adopted to conform to the provisions of this Statement should be applied retroactively by restating financial statements, if practicable, for all prior periods presented. If restatement for prior periods is not practicable, the cumulative effect, if any, of applying this Statement should be reported as a restatement of beginning net position (or fund balance or fund net position, as applicable) for the earliest period restated. Also, the reason for not restating prior periods presented should be disclosed. In the first period that this Statement is applied, the notes to financial statements should disclose the nature of the restatement and its effect.

**The provisions of this Statement need
not be applied to immaterial items.**

*This Statement was issued by unanimous vote of the seven members of the
Governmental Accounting Standards Board.*

David A. Vaudt, *Chairman*
Jeffrey J. Previdi, *Vice Chairman*
James E. Brown
Brian W. Caputo
Michael H. Granof
Kristopher E. Knight
David E. Sundstrom

Appendix A

BACKGROUND

A1. The GASB first addressed conduit debt obligations in Interpretation 2, issued in 1995. Interpretation 2 described conduit debt obligations as follows:

The term *conduit debt obligations* refers to certain limited-obligation revenue bonds, certificates of participation, or similar debt instruments issued by a state or local governmental entity for the express purpose of providing capital financing for a specific third party that is not a part of the issuer's financial reporting entity. Although conduit debt obligations bear the name of the governmental issuer, the issuer has no obligation for such debt beyond the resources provided by a lease or loan with the third party on whose behalf they are issued. [Paragraph 2; footnote reference omitted.]

A2. Conduit debt obligations generally are tax exempt, provided that they conform to relevant portions of the Internal Revenue Code. Thus, those financings are a way for not-for-profit organizations—for example, hospitals, nursing home facilities, and educational institutions—to secure financings at tax-exempt rates. Borrowers (third-party obligors) also may be for-profit entities or other governments. This structure often is used when the issuer is considered to have financing expertise and can take advantage of economies of scale (for example, a state finance authority). Many issuers receive a fee for arranging conduit debt financings, and some are government agencies organized solely to issue conduit debt obligations. Third-party obligors are identified in debt documents, such as offering statements and bond indentures. Based on the GASB's pre-agenda research, users generally consider information about conduit debt obligations to be important for assessing an issuer's role in those debt obligations.

A3. Interpretation 2 required a government issuer to disclose information about its conduit debt obligations in the notes to financial statements, including: (a) a general description of the conduit debt obligations, (b) the aggregate amount of all conduit debt obligations outstanding at the date of financial statements, and (c) a clear indication that the issuer has no obligation for the debt beyond the

resources provided by related leases or loans. Under Interpretation 2, issuers that were reporting their conduit debt obligations as liabilities on their financial statements, along with related assets, were permitted to continue doing so.

A4. Before adding a Conduit Debt Obligations project to its current technical agenda, as previously noted, the GASB conducted pre-agenda research. That research found that even though Interpretation 2 provided a description of conduit debt obligations, confusion still existed among stakeholders in determining whether a specific financing would meet that description. Application of Interpretation 2 has been inconsistent, and many financial statement users believe there should be additional information provided by issuers in their note disclosures. The research also considered the Board's work on its conceptual framework. Since the issuance of Interpretation 2, the Board has addressed note disclosures in Concepts Statement No. 3, *Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements*, and elements in Concepts Statement No. 4, *Elements of Financial Statements*. Prior to this project on conduit debt obligations, the provisions of Interpretation 2 had not been evaluated in light of those Concepts Statements.

A5. In June 2017, the members of the Governmental Accounting Standards Advisory Council (GASAC) were consulted to identify practice issues related to applying the existing standards. Issues associated with conduit debt obligations were among those ranked with the highest priorities identified by GASAC members. The Board added the Conduit Debt Obligations project to its current technical agenda in August 2017 as a practice issue project. Board deliberations began in September 2017. Throughout the Board's due process, the GASAC members and other stakeholders provided feedback on the project.

A6. In July 2018, the Board issued an Exposure Draft, *Conduit Debt Obligations*. The Board received 40 responses to the Exposure Draft from organizations and individuals. As discussed throughout Appendix B, comments and suggestions from stakeholder responses contributed to the Board's deliberations in developing the requirements of this Statement.

Appendix B

BASIS FOR CONCLUSIONS

Introduction

B1. This appendix discusses factors considered significant by Board members in reaching the conclusions in this Statement. It includes discussion of the alternatives considered and the Board's reasons for accepting some and rejecting others. Individual Board members may have given greater weight to some factors than to others.

Scope and Applicability

B2. This Statement addresses accounting and financial reporting by issuers of conduit debt obligations. The scope is consistent with that of Interpretation 2. This Statement does not address accounting and financial reporting by governments that are third-party obligors. Some respondents to the Exposure Draft requested guidance for governments that are third-party obligors. The Board believes that, from the perspective of governmental third-party obligors, the conduit debt obligation is an obligation similar to other types of debt. The Board concluded that current guidance related to debt and long-term liabilities is sufficient to address treatment by governments that are third-party obligors.

B3. As further described in paragraphs B27 and B57, issuers that make exchange or exchange-like financial guarantees or nonexchange financial guarantees associated with conduit debt obligations should follow certain recognition, measurement, and disclosure provisions of this Statement rather than the provisions of Statements 62 and 70.

Definition and Characteristics of Conduit Debt Obligations

B4. In establishing the definition and characteristics of conduit debt obligations for accounting and financial reporting purposes, the Board considered the issues identified through its pre-agenda research. The Board noted that despite the issuance of Interpretation 2 in 1995, many of the technical inquiries received by the GASB staff relating to conduit debt obligations continue to deal with the

fundamental question of what should be considered a conduit debt obligation. The Board found that there are some characteristics that stakeholders generally agree would distinguish conduit debt obligations from an issuer's other debt obligations. In developing the definition in this Statement, the Board considered potential characteristics identified in the pre-agenda research.

B5. Many stakeholders participating in the pre-agenda research noted that conduit debt obligations involve at least three parties: (a) a government that issues the debt to finance a project; (b) a third-party obligor that receives the proceeds from the debt issuance, carries out the project, and makes debt service payments; and (c) a debt holder (for privately placed loans) or a debt trustee (for publicly sold bonds) that receives the debt service payments from the third-party obligor. This type of arrangement contrasts with a debt offering in which the issuer also is the obligor. Based on those findings, the Board decided that the "three-party" aspect should be a defining characteristic of conduit debt obligations.

B6. Paragraph 2 of Interpretation 2 described conduit debt obligations as debt instruments "for a specific third party that is not a part of the issuer's financial reporting entity" (footnote reference omitted). In addition, Question 7.22.18 in Implementation Guide 2015-1 elaborated on that characteristic and highlights that a debt obligation between governments in the same reporting entity is not conduit debt. Therefore, if a debt issuer and a third-party obligor are within the same financial reporting entity, the debt should be recognized by the issuer. Many finance authorities at the state and local levels are established as component units of a primary government. The finance authorities' sole purpose is to issue debt to finance projects for their primary governments and other component units. The Board believes that if debt that is issued by a component unit for the benefit of the primary government or another component unit were to be treated as a conduit debt obligation, that treatment would not be a faithful presentation of the debt. As a result, the Board concluded that another defining characteristic of conduit debt obligations should be that the issuer and third-party obligor are not within the same reporting entity. Some respondents to the Exposure Draft described a situation in which a component unit issues debt for the benefit of a third-party obligor and the primary government promises to make appropriations to that third-party obligor for the purpose of debt service. Those respondents questioned whether that debt should be regarded as conduit debt of the primary government. The Board believes that if the third-party obligor remains primarily obligated for the debt, it is a conduit debt obligation from the perspective of the issuer (the component unit), which is the focus of this Statement.

B7. In identifying the characteristics of conduit debt obligations, the Board considered housing finance agencies, associations, or authorities that issue housing-related debt to finance (a) single-family mortgage loans for the benefit of lower income first-time homebuyers or (b) multifamily mortgage loans for the construction, acquisition, or rehabilitation of multifamily housing for the benefit of tenants with incomes below certain thresholds. The Board noted that some of that housing-related debt possesses the characteristics of conduit debt obligations, as discussed in paragraphs B5 and B6. However, the Board also noted that if a debt obligation is a parity bond of the issuer, it is subject to a parity bond indenture. Consequently, properties and revenue pledged, and other collateral relative to each parity bond issued under the same indenture can be used for any individual bond issued under the same parity bond indenture. Accordingly, under a parity bond indenture, the government becomes both the issuer and the obligor for all the bonds issued. A similar mechanism applies to cross-collateralization. During the Board's deliberations leading to the Exposure Draft, it also was noted that, in addition to housing-related financings, parity bonds and cross-collateralization may appear in other areas, including student loan financings and revolving loan programs. The Board believes that if a debt obligation is a parity bond of the issuer or is cross-collateralized with other debt of the issuer, such a debt obligation should not be considered a conduit debt obligation but, rather, the issuer's own debt obligation. Therefore, the Board concluded that another defining characteristic of a conduit debt obligation should be that the obligation is not a parity bond of the issuer, nor is it cross-collateralized with other debt of the issuer.

B8. Pre-agenda research and outreach conducted throughout the project also indicate that the third-party obligor or its agent, not the issuer, ultimately receives debt proceeds from conduit debt obligations. The Board believes that the term *ultimately* is important to describe this aspect of conduit debt obligations. There may be financings in which an issuer initially receives debt proceeds and then passes the proceeds to the third-party obligor through a debt trustee. Without specifying the *ultimate* recipient, the issuer may be viewed as the recipient of the debt proceeds, even though it is the third-party obligor that ultimately receives the debt proceeds. Similarly, the Board also believes it is important to include the third-party obligor's agent as a party that can ultimately receive the debt proceeds. The Board noted that there may be financings in which a third-party obligor designates its agent as the recipient of the debt proceeds. For example, a firm may be contracted by a charter school to build an auditorium. The charter school as a third-party obligor, designates the firm as the recipient of the proceeds from the related conduit debt obligation. In this case, the firm is acting as an agent of the charter school; therefore, the charter

school in substance receives the debt proceeds. The Board believes that whether the third-party obligor or its agent ultimately receives the debt proceeds does not change the economic substance of a conduit debt obligation. As a result, the Board concluded that another defining characteristic of conduit debt obligations should be that either the third-party obligor or its agent is the ultimate recipient of the debt proceeds.

B9. Some respondents to the Exposure Draft requested clarification on whether there is a limit on the time for which an issuer could hold debt proceeds before ultimately passing them to the third-party obligor. The Board concluded that the accounting and financial reporting standards for conduit debt obligations should not specify a limit. As a practical matter, the Board expects that the third-party obligor will request the funds, or request payment to another party for goods or services, within a relatively short period of time.

B10. Pre-agenda research and outreach also suggested that for what stakeholders believe are conduit debt obligations, the third-party obligor is primarily obligated for the debt service payments. The issuer may support debt service payments if the third party is, or will be, unable to pay because the issuer has either extended an additional commitment to the conduit debt obligation or decided to support the debt service payments through a voluntary commitment. However, despite an issuer's additional commitment or voluntary commitment (if any), the primary obligation for debt service payments still resides with the third-party obligor. Therefore, the Board concluded that this aspect of the financing should be another defining characteristic of conduit debt obligations. Some respondents to the Exposure Draft questioned whether the characteristic of being the primary obligor should include a third-party obligor's agent, similar to the characteristic about ultimately receiving proceeds. The Board concluded that only one party can be primarily obligated for debt service. Even though a third-party obligor may use an agent to make debt service payments, the Board concluded that the third-party obligor has the primary obligation for those payments.

Limited, Additional, and Voluntary Commitments Extended by Issuers Associated with Conduit Debt Obligations

B11. Even though the third-party obligor is primarily obligated for the debt, the Board believes that an issuer retains some level of commitment for the debt. The commitment may be explicit or implicit. A nongovernmental third-party obligor often seeks conduit debt financing in order to benefit from the tax-

exempt status of municipal debt. Therefore, the Board concluded that the issuer provides a limited commitment to maintain the tax-exempt status of the debt. Often, the only other commitment for payment of the debt service is to facilitate the payment of the resources provided by the third-party obligor. The Board concluded that this action also is a limited commitment on the part of the issuer.

B12. Paragraph 2 of Interpretation 2 stated that “. . . the issuer has no obligation for such debt beyond the resources provided by a lease or loan with the third party on whose behalf they are issued.” However, the pre-agenda research indicates that an issuer sometimes may extend additional commitments of its own resources that are beyond the resources provided by the third-party obligor. In those instances, the issuer agrees to support debt service payments in the event the third-party obligor is, or will be, unable to pay. Several examples of the types of those additional commitments were identified, including situations in which the issuer (a) extends a moral obligation pledge; (b) extends an appropriation pledge; (c) extends a financial guarantee; or (d) pledges its own property, revenue, or other assets as security. The Board concluded that when associated with conduit debt obligations, issuers’ additional commitments comprise contingent obligations that are not fundamentally different from similar commitments made by issuers for other types of debt. That is, the presence of an additional commitment does not, by itself, transfer the liability for the outstanding debt from the third-party obligor to the issuer. Accordingly, the Board believes the presence of any type of additional commitment(s) does not alter the “conduit” nature of conduit debt obligations.

B13. In considering examples that could demonstrate a moral obligation pledge, the Board rejected situations in which a government official makes a public statement implying that the government would support debt service payments. The Board concluded that such an assertion is the statement of an individual and not an additional commitment of the government.

B14. The Board also considered whether the reference to extending a financial guarantee in paragraph 8 only applies to a guarantee for the conduit debt obligation itself or whether it includes a guarantee by the issuer for loans made from the conduit debt proceeds. The Board concluded that for accounting and financial reporting purposes, only a guarantee of the conduit debt obligation itself represents an additional commitment. The Board believes that a guarantee for loans made from conduit debt proceeds is a separate commitment.

B15. To determine whether an issuer's additional commitments would affect the definition of a conduit debt obligation in this Statement, the Board considered two possible approaches. The first approach was to develop a broad definition that is not affected by the issuer's additional commitments, provided that all other characteristics of a conduit debt obligation are met. The second approach narrowly defined a conduit debt obligation to include only those in which the issuer's commitment is limited to resources provided by the third-party obligor, as initially defined in Interpretation 2.

B16. The Board decided that the first approach—the broader definition—was more appropriate. The Board is not convinced that there is a conceptual difference between a conduit debt obligation with a commitment that is limited to resources provided by the third-party obligor and a conduit debt obligation with additional commitments that extend beyond those resources. The broader definition provides comprehensive guidance for debt obligations that meet all characteristics of a conduit debt obligation. The pre-agenda research indicated that there are different stakeholder views regarding whether a conduit debt obligation could include an issuer's additional commitment, such as those described in paragraph 8 of this Statement. The Board believes that a broad definition that encompasses such additional commitments brings clarity to stakeholders and improves consistency and comparability in financial reporting.

B17. An issuer that has not made an additional commitment may voluntarily choose to support an obligor's debt service payments. This could occur by requesting an appropriation to pay debt service or replenish debt service reserves associated with the conduit debt obligation in the absence of a moral obligation pledge or an appropriation pledge. For governments that do not have an appropriations process, deciding to make a debt service payment on a voluntary basis also is considered a voluntary commitment.

Recognition and Measurement

Issuer Should Not Recognize a Conduit Debt Obligation as a Liability

B18. Paragraph 3 of Interpretation 2 required all conduit debt obligations to be disclosed in the notes to financial statements of the issuers. As noted in Appendix A of this Statement, Interpretation 2 permitted, but did not require, issuers to report conduit debt obligations as liabilities, along with related assets,

on the face of their financial statements. As a result, recognition of liabilities for conduit debt obligations differed from government to government. In the Basis for Conclusions of Interpretation 2, the Board stated that “its decision [on reporting conduit debt obligations] should be reconsidered after a definition of a governmental liability is developed” (paragraph 14).

B19. Concepts Statement 4 provides the definition of a liability. Paragraph 7 of Concepts Statement 4 describes the relationship between the definition of an element and its recognition in financial statements: “For an item to be recognized in a financial statement, it should meet all relevant criteria. These criteria include meeting the definition of an element, as well as meeting recognition and measurement criteria.” In addition, paragraph 17 defines liabilities as “present obligations to sacrifice resources that the government has little or no discretion to avoid.” Paragraph 22 elaborates that, “For an obligation to be a liability, it should be a present obligation. The event that created the liability has taken place. This distinguishes the item from a commitment that may become a liability in the future when the event giving rise to the liability occurs. The government may be able to withdraw from or avoid the commitment until a future event giving rise to the liability occurs.”

B20. The Board believes that the definition of a liability in Concepts Statement 4 leads to the conclusion that a conduit debt obligation is not a liability of an issuer and should not be recognized in the issuer’s financial statements. Based on the definition of conduit debt obligations in this Statement, it is the third-party obligor, not the issuer, that has the primary obligation for the debt service payments. Because the issuer is not the obligor, the issuer does not have a “present obligation to sacrifice resources” to make debt service payments. The issuer’s commitment (if any) is an expression of its willingness to support debt service payments with its own resources in the event the third-party obligor is, or will be, unable to make payments in the future. The future event that would create a liability for the issuer (the third-party obligor being unable, or expected to be unable, to make its payments) has not taken place at the time a conduit debt obligation is issued. In other words, even if the issuer makes an additional commitment, the conduit debt obligation does not represent a present obligation of the issuer to sacrifice resources. Therefore, the Board concluded that an issuer should not recognize a conduit debt obligation as a liability.

B21. Some respondents to the Exposure Draft were concerned about the impact that the Board’s decision would have on governments that currently recognize a liability and related asset for conduit debt obligations. Many of those

governments are finance authorities with few other assets and liabilities. Respondents expressed concern about the effect of derecognizing those liabilities and assets and the ability of those governments to communicate the magnitude of their operations only through disclosures. The Board believes that consistency between issuers and the application of the conceptual definition of a liability outweigh the concerns that have been expressed. The Board recognizes that disclosure is not a substitute for recognition. However, if a commitment does not meet the definition of a liability, the Board believes that reporting that commitment as a liability would not result in a representationally faithful presentation. Therefore, the Board concluded that disclosure of those limited commitments is the appropriate communication method in this situation.

Recognition and Measurement of Liabilities Resulting from an Issuer's Additional Commitments

B22. Although a conduit debt obligation is not a *present* obligation and, therefore, does not meet the definition of a liability for an issuer, additional commitments extended by the issuer represent contingent obligations. An obligation is defined in paragraph 18 of Concepts Statement 4 as “a social, legal, or moral requirement, such as a duty, contract, or promise that compels one to follow or avoid a particular course of action” (footnote reference omitted). When an issuer extends an additional commitment associated with a conduit debt obligation, the issuer agrees to support debt service payments with its own resources, if the third-party obligor is or will be unable to make such payments. Whether a specific additional commitment would rise to the level of a present obligation and be required to be recognized as a liability depends on whether the recognition criteria are met.

B23. Recognition criteria are not addressed in the existing conceptual framework. Recognition refers to *when* an element—such as a liability—should be reported in a financial statement. The Board believes the most relevant existing guidance for recognition criteria for those types of commitments is (a) recognize a liability when payment is *probable*, as provided in paragraphs 96–113 of Statement 62 and (b) recognize a liability when payment is *more likely than not*, as provided in paragraphs 9 and 10 of Statement 70.

B24. The Board's main concern is that using *probable* as the recognition threshold may cause recognition by an issuer to be delayed, resulting in an understatement of liabilities and expenses. That concern is based on anecdotal evidence that indicates that applying a probable threshold in practice often

delays recognition until a payment becomes imminent. Conversely, if *more likely than not* is used as the recognition benchmark for liabilities resulting from an issuer's additional commitments associated with conduit debt obligations, consistency and comparability of recognition would be enhanced. Therefore, the Board decided the recognition criterion for a liability resulting from an issuer's additional commitments in conduit debt obligations should be when the likelihood of the issuer making a payment to support debt service is more likely than not—defined in Statement 70 as a likelihood of more than 50 percent.

B25. The Board believes that, in addition to the recognition criterion in Statement 70, it would be equally appropriate if the measurement guidance in Statement 70 is adopted for the transactions and other events addressed in this Statement.

B26. For recognition in financial statements prepared using the current financial resources measurement focus, this Statement requires that a liability that results from an issuer's additional commitment or voluntary commitment to support debt service be recognized to the extent the liability is normally expected to be liquidated with expendable available financial resources. That is consistent with the guidance provided in Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*, as amended. The Board believes that governmental fund liabilities related to additional commitments are normally expected to be liquidated when a payment under that commitment is due and payable.

B27. Some respondents to the Exposure Draft requested clarification on which guidance to follow if the additional commitment associated with a conduit debt obligation is a nonexchange financial guarantee that also would be considered within the scope of Statement 70. Although this Statement and Statement 70 have the same general approach, this Statement focuses exclusively on conduit debt obligation transactions and, therefore, specifically addresses guarantees associated with those transactions. Therefore, as previously noted in paragraph B2, the Board believes that removing such commitments from the scope of Statement 70 would reduce confusion as to which standards should be applied. In addition to the more detailed list of qualitative factors to consider, the Board also did not want to create a difference between guarantees of conduit debt obligations that are exchange or exchange-like transactions and those that are nonexchange. However, exchange or exchange-like financial guarantees normally would be within the scope of Statement 62, which contains recognition and measurement guidance that is different from this Statement. The Board believes that similar treatment for commitments related to conduit debt obli-

tions is more important than similar treatment for different types of exchange or exchange-like financial guarantees and, therefore, decided to remove exchange or exchange-like financial guarantees associated with conduit debt obligations from the scope of Statement 62.

B28. This Statement specifies that an issuer that has made an additional commitment should evaluate at least annually whether the criteria for recognizing a related liability are met. Because the conduit debt obligation itself is not recognized as a liability, the Board believes that issuers should evaluate, as long as the conduit debt obligation is outstanding, their additional commitments to determine whether a liability associated with these commitments should be recognized. Additionally, the Board believes that the requirement to evaluate *at least annually* relieves some of the burden for governments that prepare GAAP financial statements on a more frequent basis, such as quarterly, so that they do not need to do the evaluation at each financial statement date.

B29. Some respondents to the Exposure Draft requested guidance for derecognition of a liability for an additional commitment. Because recognition is based on an evaluation of likelihood, it is possible that the likelihood that a payment(s) would be required could decrease after the recognition of a liability. Therefore, the liability would need to be derecognized without a payment being made. The Board noted that accounting and financial reporting issues for derecognition are not unique to a liability associated with a conduit debt obligation and, therefore, the Board concluded that derecognition does not require specific guidance in this Statement.

B30. Some respondents to the Exposure Draft requested guidance for recognition of a receivable for any expected recoveries by an issuer that has made a payment to support the debt service of a third-party obligor. In those circumstances, the Board concluded that the current guidance for gain contingencies in paragraph 112 of Statement 62 is sufficient and, therefore, does not need to be specifically addressed in this Statement.

Qualitative Factors in Assessing Whether It Is More Likely Than Not That an Issuer Will Support Debt Service Payments

B31. The Board acknowledges that the evaluation of the likelihood of whether an issuer may support debt service payments for a conduit debt obligation can be difficult. Statement 70 provides a list of qualitative factors as examples that may indicate when a guarantor's payment for a nonfinancial guarantee is more

likely than not. The Board concluded that similar and comparable guidance should be provided to assist issuers in evaluating whether it is more likely than not that they will support debt service payments of a conduit debt obligation.

B32. Statement 70 addresses nonexchange financial guarantees, which is one type of commitment. This Statement, however, expands the definition of a conduit debt obligation to include those with additional commitments that are not limited to financial guarantees. Therefore, the Board decided other qualitative factors are needed to help issuers evaluate whether it is more likely than not that they will support debt service payments of a conduit debt obligation.

B33. Some respondents to the Exposure Draft expressed concern about the burden of evaluating the qualitative factors provided in paragraph 13 on an annual basis for every conduit debt issuance, even if the issuer only has a limited commitment. After considering that concern, the Board decided not to require an annual evaluation for an issuer that has not made an additional commitment or a voluntary commitment (as described in paragraph B17). For an issuer that has made an additional commitment or a voluntary commitment, however, the Board believes that the qualitative factors listed are reasonable factors to consider when evaluating the issuer's risk exposure due to that commitment.

Recognition and Measurement of Liabilities Resulting from an Issuer's Voluntary Commitments

B34. The Board believes that a voluntary commitment should be considered for recognition as a liability in the financial statements for the same reasons that an additional commitment should be considered, as discussed in paragraph B22. The Board considered requiring every issuer of a conduit debt obligation to perform an annual evaluation of the likelihood of a debt service payment being made. However, some issuers may only issue conduit debt obligations with limited commitments and rarely, if ever, choose to voluntarily support the debt service of those obligations. The Board concluded that requiring an annual evaluation in those circumstances would place a significant and unnecessary burden on those issuers.

B35. If it is more likely than not that an issuer will make a payment under a voluntary commitment, the Board concluded that a liability should be recognized. As previously noted, the Board decided not to require an annual evaluation for an issuer that has not made an additional commitment or a voluntary

commitment. However, the Board decided that an evaluation is required when a triggering event has occurred, such as a high-profile obligor experiencing financial distress, or a circumstance has changed, such as new governing body members, that causes the issuer to consider supporting one or more debt service payments.

B36. If an issuer decides, after an evaluation following a triggering event, that qualitative factors indicate it is more likely than not that the issuer will make a debt service payment, the issuer should recognize a liability using the same measurement provisions applied to a liability for an additional commitment. The Board believes that after an issuer recognizes a liability for a voluntary commitment, the issuer has indicated its willingness to voluntarily support debt service payments and, therefore, should perform an annual evaluation of qualitative factors going forward. The annual evaluation is required only for the issue for which a liability was recognized, not the entirety of an issuer's portfolio. The Board believes the incremental burden on the issuer is justified because of the likelihood of payments being made. However, the Board believes that the likelihood of a voluntary payment being made for one issue does not necessarily indicate an enhanced likelihood of a voluntary payment being made for all issues.

Arrangements Associated with Conduit Debt Obligations

B37. Many conduit debt obligations do not have arrangements, such as those discussed in paragraphs 18–23, associated with them. However, in some cases, governments issue conduit debt obligations to finance the construction or acquisition of capital assets for third-party obligors—usually private-sector entities—to use in the third parties' operations, even though the issuers retain the titles to the capital assets. Generally, the capital assets financed by conduit debt obligations are pledged as collateral for the benefit of debt holders. The payments from those arrangements—frequently characterized as leases—are structured to cover debt service payments on the conduit debt obligations and are made by the third-party obligors to debt holders or debt trustees. However, there are differences within those arrangements that are significant enough to warrant distinguishing three separate categories.

B38. In the first category of arrangements, as described in paragraph 19a of this Statement, an issuer holds the title to the capital asset until the arrangement ends, at which time the title is transferred to the third-party obligor

(generally when the debt is paid off). In the second and third categories of arrangements, as described in paragraphs 19b and 19c of this Statement, respectively, the issuer does not transfer the title to the capital asset to the third-party obligor, even after the arrangement ends. Although similar, there is a significant difference between the categories described in paragraph 19b and paragraph 19c. In paragraph 19b, the third-party obligor has exclusive use of the entire capital asset during the length of the arrangement. In paragraph 19c, the third-party obligor has exclusive use of only *portions* of the capital asset during the length of the arrangement.

B39. The Board considered whether liabilities should be recognized for those conduit debt obligations that finance facilities on property owned by the issuer and for which no transfer of ownership to the third-party obligor occurs. That approach would require an issuer to recognize a liability in the arrangements described in both paragraphs 19b and 19c of this Statement. However, as discussed in paragraph B20, the Board believes that the conduit debt obligation does not meet the conceptual definition of a liability, regardless of whether the debt proceeds finance facilities owned by the issuer.

B40. Some arrangements associated with conduit debt obligations may meet the definition of SCAs in paragraph 4 of Statement 60. In that case, the Board believes that the arrangement should follow the guidance in Statement 60 because that guidance already addresses the specific situation. The issuer of a conduit debt obligation also would be the transferor government in an SCA if the definition in Statement 60 is met. Although the associated arrangement would follow the guidance in Statement 60 instead of the guidance in paragraphs 20–23 of this Statement, the Board concluded that the debt still should be considered conduit debt from the perspective of the issuer.

B41. Those additional arrangements associated with conduit debt obligations also are excluded from the scope of Statement 87. Specifically, Statement 87 excludes from its scope “leases in which the underlying asset is financed with outstanding conduit debt, unless both the underlying asset and the conduit debt are reported by the lessor” (paragraph 8e). In the Basis for Conclusions of that Statement, paragraph B16 explains that those arrangements are excluded because of the accounting complexities associated with those transactions and the then ongoing pre-agenda research activity to reexamine conduit debt obligations. This Statement amends Statement 87 to exclude arrangements associated with conduit debt obligations, as defined in this Statement.

B42. Given the history and complexity of the issue, the Board concluded that specific guidance should address the accounting recognition issues resulting from such arrangements associated with conduit debt obligations. The Board believes the existence of those arrangements in any of the three categories described in paragraph 19 of this Statement does not change the nature of the associated conduit debt obligations. In substance, the payments from the third-party obligors are not “lease payments” but, rather, debt service payments to debt holders or debt trustees. Consequently, the Board concluded that, for all three categories, an issuer should *not* recognize (a) a liability for the related conduit debt obligation, (b) a receivable for the payments related to the arrangement, or (c) the arrangement as a lease.

B43. The Board also considered potential recognition of the capital assets financed with the conduit debt obligations and analyzed each of the three categories independently. Paragraph 8 of Concepts Statement 4 defines assets as “resources with present service capacity that the government presently controls.” As previously noted, in the first category, an issuer has the title to the capital asset but relinquishes it to the third-party obligor at the end of the arrangement, at which time the conduit debt obligation generally is paid off. From the issuer’s perspective, at no point is there present service capacity associated with that capital asset. Therefore, the Board concluded in that case that the issuer should not recognize the capital asset as its own at any time.

B44. In the second category of arrangements, an issuer retains the title to the capital asset. The third-party obligor has exclusive use of the *entire* capital asset until the end of the arrangement. The issuer does not relinquish the title to the capital asset to the third party at the end of the arrangement. As previously noted, paragraph 8 of Concepts Statement 4 defines assets as “resources with present service capacity that the government presently controls.” Although the issuer has the title, there is no present service capacity associated with the capital asset from the issuer’s perspective as long as the third-party obligor has exclusive use of it. The issuer cannot use the present service capacity of the capital asset to fulfill its mission to provide public services. While there may be a public benefit derived from the capital asset (such as job creation or economic growth), the asset generally is not used for services that the government would provide directly. Furthermore, the payments made pursuant to the arrangement do not go to the issuer but, rather, to debt holders or debt trustees. Thus, from the issuer’s standpoint, the capital asset is not an income-producing asset and does not provide present service capacity in the form of economic benefits. Therefore, the Board concluded that in the second category of arrangements, the issuer should not recognize a

capital asset during the additional arrangement. The Board also considered whether the issuer should recognize a receivable for the capital asset but rejected this alternative because the capital asset is not being used to provide direct public services during the arrangement. However, when the additional arrangement ends, at which time the third-party obligor will no longer have exclusive use of the capital asset, the issuer not only will retain the title to the capital asset but also will have access to the present service capacity of that capital asset. Therefore, in that case, the Board concluded that the issuer should, at the end of the arrangement, recognize the capital asset. The Board concluded that the capital asset should be recognized at acquisition value, which is an entry price and, therefore, is consistent with the item becoming an asset of the issuer. At that time, the Board also concluded that an inflow of resources should be recognized because it relates to the period in which the arrangement ends.

B45. In the third category of arrangements, an issuer retains the title to the capital asset. The third-party obligor has exclusive use of only *portions* of the capital asset until the end of the additional arrangement. The other portions of the capital asset may be used by the issuer or the general public. Because the third-party obligor does not have exclusive use of the entire capital asset, the Board believes that the capital asset taken as a whole possesses present service capacity for the issuer.

B46. The Board considered whether an issuer should divide the capital asset into two separate units of account, based on the relative proportions of exclusive and nonexclusive uses. The Board recognizes the conceptual basis of this approach because the application of *unit of account* would allow an asset to be divided and accounted for separately. However, if separation is required, the issuer would recognize the asset and related depreciation only for the portions of the capital asset that are for nonexclusive use. For practical reasons, the Board concluded that separation of the asset should not be permitted. That conclusion is similar to that reached by the Board in Statement 87. That Statement does not allow separating the capital asset underlying a lease; rather, the lessor cannot derecognize the capital asset. The Board believes that from a practical standpoint, the effort associated with separating the underlying asset does not appear to be cost-beneficial. Therefore, the Board concluded that in the third category of arrangements, the issuer should recognize the entire capital asset rather than only the nonexclusive-use portions.

B47. The Board also considered alternatives for recognition of the credit when an issuer recognizes the capital asset in the arrangement described in the third category. Statement No. 65, *Items Previously Reported as Assets and Liabilities*, provides the “approach that established a hierarchy for applying the definitions of the elements in Concepts Statement 4” (paragraph 45). Based on that approach, the Board first evaluated an item as a potential asset or liability as defined in Concepts Statement 4. If it does not meet one of those definitions, the item should be tested against the definition of a deferred outflow of resources or a deferred inflow of resources. Finally, if the item does not meet the definition of a deferred outflow of resources or a deferred inflow of resources, it should be considered for recognition as an outflow of resources or an inflow of resources.

B48. The Board applied that approach when considering what the credit should be when an issuer recognizes the capital asset in category three. Because the Board had previously determined that an issuer should not report a liability for the related conduit debt obligation that finances the capital asset in those arrangements, the Board considered whether the potential credit meets the definition of a deferred inflow of resources. The Board believes that an issuer’s position in that category is comparable to a transferor’s position in the arrangements described in paragraphs 9 and 12 of Statement 60. In Statement 60, when a facility under an SCA is newly constructed or purchased by the operator, the transferor should report the new facility as a capital asset and a corresponding deferred inflow of resources. In category three, the Board concluded that even though the issuer should not report a liability for a conduit debt obligation, recognition of a capital asset and a deferred inflow of resources still is appropriate. Therefore, to be consistent with the Statement 60 guidance, the Board decided the appropriate credit when the issuer recognizes the capital asset should be a deferred inflow of resources.

B49. Some respondents to the Exposure Draft requested further guidance on whether and when the third-party obligor should report the capital asset if the issuer does not report it. The Board believes that such guidance is outside the scope of this Statement, which is limited to accounting and financial reporting by issuers. Additionally, many third-party obligors are not governmental entities and, therefore, not subject to the jurisdiction of the Board.

Disclosure Requirements of This Statement

B50. In addition to the concepts set forth for the notes to financial statements in Concepts Statement 3 and the feedback from GASAC members and subject-matter experts, the Board considered the disclosures required by Statements 62 and 70 and Interpretation 2. Because each of those pronouncements provides guidance for transactions that are relevant to conduit debt obligations, the Board decided to develop the disclosure requirements for conduit debt obligations based on those standards rather than create an entirely new set of disclosures. The Board believes that providing consistent and comparable disclosures for conduit debt obligations is practical and will reduce costs.

B51. The pre-agenda research indicated that stakeholders generally find the disclosures required by paragraph 3 of Interpretation 2 to be valuable for making decisions and assessing accountability. The Board believes that those disclosures offer users important insights into items that may not be on the face of the financial statements, one of the guiding principles for note disclosures found in Concepts Statement 3. The Board concluded that those disclosure requirements should be incorporated into this Statement.

B52. The disclosure requirements from Interpretation 2 were revised to conform to the broad definition of a conduit debt obligation in this Statement, which encompasses all issuers' commitments. With the conforming edits, the disclosure of outstanding conduit debt obligations is organized by the type of commitment and includes a general description of each type. The Board also concluded that there is information that should be included in the general description of additional commitments, similar to the requirements of Statement 70 for the description of nonexchange financial guarantees. The Board believes that this information is essential to understanding the risks associated with additional commitments. The pre-agenda research found that variation in the types of commitments issuers extend creates uncertainty about finance-related consequences to issuers, because it may be unclear whether those commitments will compel an issuer to sacrifice its own resources to support the debt service payments. Based on that research and responses to the Exposure Draft, the Board believes that the required disclosures would provide essential information about conduit debt obligations and give additional insights into potential outflows of resources from issuers.

B53. Some respondents to the Exposure Draft requested that the disclosures in paragraph 25 only be required for conduit debt obligations for which the issuer has made an additional commitment or a voluntary commitment. In their view, conduit debt obligations with only limited commitments do not pose enough risk to the issuers to justify the cost of preparing the disclosures. However, the Board believes that because there is no liability recognized for conduit debt obligations with only limited commitments, disclosures about those commitments in the notes are necessary to communicate information about the nature and volume of an issuer's activities.

B54. Paragraph 25a requires a general description of the issuer's conduit debt obligations, as was required by Interpretation 2. The Board believes that it generally is not necessary to describe each individual issuance in detail; however, only listing each conduit debt obligation is not sufficient to describe the obligations because it does not describe the commitments the issuer has made. Interpretation 2 required a disclosure that the issuer has no obligation for the conduit debt beyond the resources provided by related leases or loans. Because Interpretation 2 only addressed conduit debt obligations with limited commitments, that declaration of no other obligation was applicable. However, because this Statement expands the definition of conduit debt obligations to include those with additional commitments and voluntary commitments, the Board concluded that it would no longer be appropriate to require such a declaration.

B55. Interpretation 2 required disclosure of the aggregate amount of conduit debt obligations outstanding at the balance sheet date. However, in footnote 2, an exception to disclose the original issue amount for conduit debt issued prior to implementation of that Interpretation was allowed if the aggregate amount outstanding was not determinable or could not be reasonably estimated. Because of the length of time that has passed since Interpretation 2 became effective, that exception applies to few conduit debt issuances for which balances still may be outstanding. This Statement carries forward the requirement to disclose the outstanding amount at the end of the financial reporting period without exception. This Statement also requires the aggregate amount to be separated by type of commitment. The Board believes that this disclosure provides essential information about the magnitude of the issuer's conduit debt activity and potential exposure. Some respondents to the Exposure Draft expressed concerns about the requirement to disclose the outstanding balance, believing the benefit of the disclosure would not justify the potential burden of obtaining the information, particularly for conduit debt for which the issuer only has a limited commitment. The Board considered allowing those issuers with

only limited commitments to disclose the original issue amount but decided that the original issue amount loses relevance as time passes and would no longer be considered essential information. The Board believes that if mechanisms were developed to collect data in order to comply with the Interpretation 2 disclosure requirements, it generally would not be difficult to obtain the current outstanding balance.

B56. This Statement provides that if an issuer has recognized a liability related to its conduit debt obligations or has made payments related to its conduit debt obligations during the reporting period, it should disclose the information required by paragraph 26. The Board concluded that those disclosures provide essential detail about the amounts recognized in the financial statements, especially considering the Board's decision that conduit debt obligations can carry additional commitments or voluntary commitments of an issuer's own resources beyond those provided by the third-party obligor. The Board believes that for situations in which a related liability results from those additional commitments or voluntary commitments, that information will allow users to better understand the issuer's ongoing financial responsibilities related to conduit debt obligations.

B57. Some additional commitments under this Statement are financial guarantees that already have disclosure requirements in Statement 62 (for exchange or exchange-like financial guarantees) or Statement 70 (for nonexchange financial guarantees). The Board believes that disclosures made under the requirements of this Statement also would meet the requirements of Statements 62 and 70. However, the Board believes that removing financial guarantees associated with conduit debt obligations from the disclosure requirements of Statements 62 and 70 would reduce confusion as to which requirements should be applied.

Disclosures Considered but Not Required

B58. The pre-agenda research and responses to the Exposure Draft indicated that some stakeholders believe that information about the identity, credit rating, and payment history of the third-party obligor would help them assess an issuer's potential obligations. Some stakeholders also believe that disclosures of project information—such as whether (a) a conduit debt obligation satisfies the financial needs of the program it is financing, (b) taxpayers benefit from the program financed by the conduit debt obligation, and (c) the conduit debt financing is the lowest cost of borrowing and most expeditious way to finance

the project—may be useful to assessing the issuer’s accountability and transparency. The Board acknowledges the potential interest in those disclosures but believes such information is not essential for users’ understanding of the financial aspects of the conduit debt obligations. Essentiality is one of the criteria required by Concepts Statement 3 to be met before any information is included in the notes to financial statements. The Board noted that the potential disclosures about third-party obligors would require disclosures of that information for each individual conduit debt obligation, which are overly burdensome for issuers, especially those with many conduit debt obligations. The Board concluded that the benefits of providing this information do not justify the cost associated with accumulating the information. The Board also noted that gathering information on the associated projects could require significant efforts that the Board believes are not justified by the usefulness of the information. Therefore, the Board concluded that disclosure of information about third-party obligors and the projects associated with the conduit debt obligations should not be required.

B59. As previously noted, this Statement does not require an issuer to recognize a liability for additional commitments related to a specific conduit debt obligation unless it is more likely than not that the issuer will make a payment to support the third-party obligor’s debt service. In addition, the issuer is required to disclose information about a recognized liability. However, there may be instances in which an issuer’s additional commitment for each individual conduit debt obligation does not meet the recognition criteria, but when all such commitments are considered in the aggregate, it becomes more likely than not that some additional commitment will be honored. In those situations, the issuer may need to consider the disclosure requirements in paragraph 107 of Statement 62, as amended, when no liability is recognized for a loss contingency. The Board considered adding a specific requirement in this Statement for such a disclosure because some preparers may not realize that the disclosure requirement in Statement 62 would apply to conduit debt obligations in the situation described above. However, the Board believes that the loss contingency literature in Statement 62 is well known to preparers and already provides sufficient guidance for reporting loss contingencies. Therefore, the Board decided that including a reference to disclosures that may be required by other loss contingency literature is not necessary.

B60. Some respondents suggested disclosure requirements in addition to those proposed in the Exposure Draft. In addition to potential disclosures already discussed in this section, a disclosure stating that conduit debt obligations are not recognized as liabilities in the financial statements was proposed.

The Board concluded that such a disclosure should not be required. Although it is a factual statement, the Board believes it is not necessary to explain the accounting for conduit debt obligations in the notes because it is assumed that financial statement users have a reasonable understanding of the fundamentals of governmental financial reporting, as described in Concepts Statement 3.

Considerations Related to Benefits and Costs

B61. The overall objective of financial reporting by state and local governments is to provide information to assist users (the citizenry, legislative and oversight bodies, and investors and creditors) in assessing the accountability of governments and in making economic, social, and political decisions. One of the principles guiding the Board's setting of standards for financial reporting is the assessment of the expected benefits and perceived costs. The Board strives to determine that its standards (including disclosure requirements) address a significant user need and that the costs incurred through the application of its standards, compared with possible alternatives, are justified when compared to the expected overall public benefit.

B62. Present and potential users are the primary beneficiaries of improvements in financial reporting. Persons within governments who are responsible for keeping accounting records and preparing financial statements, as well as managers of public services, also benefit from the information that is collected and reported in accordance with GASB standards. The costs to implement the standards are borne primarily by governments and, by extension, their citizens and taxpayers. Users also incur costs associated with the time and effort required to obtain and analyze new information to meaningfully inform their assessments and decisions.

B63. The Board's assessment of the expected benefits and perceived costs of issuing new standards is unavoidably more qualitative than quantitative because no reliable and objective method has been identified for quantifying the value of improved information in financial statements. Furthermore, it is difficult to accurately measure the costs of implementing new standards until implementation has taken place. Nonetheless, the Board undertakes this assessment based on the available evidence regarding expected benefits and perceived costs with the objective of achieving an appropriate balance between maximizing benefits and minimizing costs.

B64. Practice was inconsistent, and the conceptual framework project was pending when Interpretation 2 was issued. The Board decided then that liability recognition of conduit debt obligations would be reconsidered after a definition of a governmental liability was developed. As previously noted, since the issuance of Interpretation 2, the Board has addressed the definition of liabilities through Concepts Statement 4. Before this Statement, the provisions in Interpretation 2 had not been evaluated in light of the conceptual framework with regard to whether or when conduit debt obligations should be reported as an issuer's liability. The Board believes that this Statement will provide consistency by eliminating an option (recognition of a liability by an issuer for a conduit debt obligation) that does not have a conceptual basis under Concepts Statement 4. Additionally, consistency is achieved by requiring recognition only when an additional commitment or a voluntary commitment meets the conceptual definition of a liability and the recognition threshold of more likely than not. The Board also believes that eliminating the option to recognize a liability for a conduit debt obligation under Interpretation 2 and providing specific guidance on additional commitments, voluntary commitments, and arrangements associated with conduit debt obligations will improve the comparability of financial reporting.

B65. The Board gathered information on the expected benefits of improving the conduit debt obligations standards primarily through input from pre-agenda research, the GASAC members, and outreach with stakeholders. Feedback also was obtained from comment letters submitted in response to the Exposure Draft. The feedback indicated that users need additional information beyond the disclosures required by Interpretation 2. For example, some users expressed the concern that existing disclosures do not provide sufficient information related to an issuer's risk in the event of a third-party obligor's default. Some users indicated the importance of knowing different commitments that issuers extend. Some users, including financial community analysts, believe there is a benefit in understanding the additional commitments issuers have made on conduit debt obligations and the potential impact of such commitments on the resources of the issuers. The Board believes that the recognition criteria and disclosure requirements organized by type of commitment of this Statement are responsive to the needs expressed by the users.

B66. The Board considered the anticipated costs in two categories: costs of applying the guidance similar to existing standards and costs of applying the recognition, measurement, and additional disclosure requirements for an issuer's commitments that rise to the level of liabilities. As noted in paragraph B33, the Board believes some ongoing costs will be avoided by using a triggering

event approach, rather than requiring annual evaluation, for an issuer that has only limited commitments related to conduit debt obligations. For the disclosure guidance in this Statement that is similar to the existing disclosure requirements in Interpretation 2, most governments are not expected to have a large incremental burden to comply. The pre-agenda research indicates that governments either already have the information available or have access to the information. When an issuer's commitment rises to the level of a liability, the recognition, measurement, and additional disclosure guidance in this Statement will apply. However, the Board believes that, based on the research conducted, it is unlikely that a substantial portion of an issuer's commitments associated with conduit debt obligations would be recognized as liabilities because many conduit debt obligations do not have issuer-extended additional commitments. Also, the disclosure requirements for liabilities arising from conduit debt obligations are based on Statement 70 with conforming edits. Many preparers and auditors already should be familiar with the disclosures required by that Statement. The Board believes that those factors would mitigate implementation and ongoing costs. In addition, the transition provisions discussed in paragraphs B69 and B70 are intended to mitigate costs of implementation.

B67. The Board also considered the aggregate expected benefits and perceived costs associated with the entirety of the requirements in this Statement. Although the Board recognizes that it is difficult to accurately measure the costs of implementing new standards, the Board believes that the costs of implementing this Statement will be low in most cases. Also, stakeholders will derive substantial benefits from the significantly improved information on conduit debt obligations. The Board believes that the expected benefits that will result from the information provided through implementation of this Statement are significant and justify the perceived costs of implementation and ongoing compliance.

Effective Date and Transition

B68. The provisions of this Statement are effective for reporting periods beginning after December 15, 2020. The Board believes the effective date is appropriate because most issuers of conduit debt obligations currently report or can readily determine the amount of outstanding conduit debt obligations and related information to be disclosed. The Board acknowledges that implementation will be more difficult for governments with many conduit debt obligations.

The Board concluded that the effective date allows adequate time for the financial statement preparers to plan for transition and implementation. Some governments may wish to implement the guidance earlier than that date, which this Statement encourages.

B69. The Board believes that this Statement should be applied retroactively to encourage consistency and comparability. However, the Board considered the potential for the lack of readily available information for the restatement of all prior periods and for similar disclosure requirements. Accordingly, the Board recognized that it may not be practicable to restate all prior periods.

B70. The phrase *if practicable* (in paragraph 28) has been used in other GASB standards in a similar context as used in this Statement with respect to transition provisions that require restating the financial statements for all prior periods presented. The Board believes that reasonable efforts should be employed before a government determines that restatement of all prior periods presented is not practicable. In other words, *inconvenient* should not be considered equivalent to *not practicable*.

Appendix C

ILLUSTRATIONS

C1. This appendix illustrates certain requirements of this Statement. The examples are illustrative only and are not intended to modify or limit the requirements of this Statement or to indicate the Board's endorsement of the policies or practices shown. Application of the provisions of this Statement may require assessment of facts and circumstances other than those illustrated here. Disclosures set forth in other GASB pronouncements, in addition to those shown in Illustration 2, are required, if applicable.

Illustration 1—Application of the Definition of a Conduit Debt Obligation

The following are examples of application of the guidance in this Statement to determine whether a debt obligation is a conduit debt obligation.

Example 1—Bonds That Meet the Definition of a Conduit Debt Obligation

Facts and Assumptions

An economic development agency issues industrial development bonds on behalf of a company to finance construction of a manufacturing facility for the company.

The manufacturing facility is pledged as collateral for the debt, and the bonds are payable solely from the payments received from the company on a mortgage on the manufacturing facility. No other collateral, security, or commitment is provided by the economic development agency to support the debt service payment of the bonds.

The bonds are not parity bonds of the economic development agency, nor are they cross-collateralized with other debt of the economic development agency.

The company, through the debt trustee, receives the debt proceeds to pay for the cost of construction of the manufacturing facility. The company makes debt service payments to the debt holders through the debt trustee until the bonds are paid off.

Determination

The industrial development bonds meet the definition of a conduit debt obligation. The bonds are issued in the name of a local government (the economic development agency) for the benefit of a third-party obligor (the company). The bonds also have the required characteristics in paragraph 6 of this Statement:

- a. At least three parties are involved in the obligation: an issuer (the economic development agency), a third-party obligor (the company), and a debt trustee.
- b. The economic development agency and the company are not within the same financial reporting entity.
- c. The bonds are not parity bonds of the agency, nor are they cross-collateralized with other debt of the economic development agency.
- d. The company, not the economic development agency, ultimately receives the proceeds of the bonds.
- e. The company, not the economic development agency, is primarily obligated for the debt service payments of the bonds.

Example 2—Bonds That Do Not Meet the Definition of a Conduit Debt Obligation

Facts and Assumptions

A state housing finance authority issues multifamily housing bonds. The bonds' proceeds are made available to various developers, enabling them to participate in the authority's affordable multifamily housing developments.

The bonds are issued under a parity bond indenture that is cross-collateralized with multiple series of multifamily housing bonds of the authority. All the bonds under that same parity bond indenture carry the same security pledge of the authority.

The bond proceeds are received by the developers through the debt trustee to finance the construction of the multifamily housing developments. The developers make debt service payments to the debt holders through the debt trustee until the bonds are paid off. The mortgage loan revenue and investments provide the security pledge and cross-collateralization for the bonds and are the sources for the debt service payments.

Determination

The multifamily housing bonds are *not* conduit debt obligations. Although they meet most of the criteria in paragraph 6 of this Statement, they do not meet the specific criterion in paragraph 6c because they are parity bonds of the authority and are subject to cross-collateralization.

Illustration 2—Disclosures

As previously noted, this illustration includes only note disclosures required by this Statement. Existing standards may require disclosures in addition to those illustrated. Those disclosures are not related to the examples in Illustration 1 for the determination of whether a debt obligation meets the definition of a conduit debt obligation.

Example 1—An Issuer Makes a Commitment Limited to Resources Provided by the Third-Party Obligor and Maintains the Tax-Exempt Status of the Debt

Facts and Assumptions

To further economic development in the County, the County Development Authority has issued bonds that meet the definition of a conduit debt obligation. Those bonds have provided private-sector entities with access to capital for the acquisition and construction of industrial and commercial facilities. The bonds are secured by the property they finance and are payable solely from payments received from the private-sector entities on the underlying mortgage or promissory notes. The County Development Authority has not extended any additional commitments for the debt service payments of the bonds beyond the collateral and the payments from the private-sector entities on the underlying mortgage or promissory notes and maintenance of the tax-exempt status of the conduit debt obligation. At June 30, 20X7, the bonds have an aggregate

outstanding principal amount payable of \$37.5 million, none of which was recognized as a liability by the County Development Authority.

Illustrative Disclosure in the County Development Authority's Financial Statements

Note J. Conduit Debt Obligations

To further economic development in the County, the County Development Authority has issued bonds that provide capital financing to private-sector entities for the acquisition and construction of industrial and commercial facilities. The properties financed are pledged as collateral, and the bonds are payable solely from payments received from the private-sector entities on the underlying mortgage or promissory notes. In addition, no commitments beyond the collateral, the payments from the private-sector entities, and maintenance of the tax-exempt status of the conduit debt obligation were extended by the County Development Authority for any of those bonds. At June 30, 20X7, the bonds have an aggregate outstanding principal amount payable of \$37.5 million.

Example 2—An Issuer Makes an Additional Commitment beyond the Resources Provided by the Third-Party Obligor for Some Conduit Debt Obligations and Does Not Meet the Criteria for Recognizing a Liability Associated with the Additional Commitment

Facts and Assumptions

The City has issued education facilities bonds that meet the definition of a conduit debt obligation to finance the construction of new buildings by several charter schools. The schools are not component units of the City. The buildings financed by the bond proceeds are pledged as collateral for the bonds. The charter schools are the obligors of the underlying mortgage loans for those buildings. The bonds are payable solely from payments received from the charter schools on the mortgage loans. The City has not extended any commitments for the debt service payments of those bonds beyond the collateral and the payments on the mortgages from the charter schools and maintenance

of the tax-exempt status of the conduit debt obligations. At June 30, 20X7, the bonds have an aggregate outstanding principal amount payable of \$48.5 million, none of which was recognized as a liability by the City.

To further economic development in the City, the City also has issued industrial development bonds that meet the definition of a conduit debt obligation. The bonds provided capital financing for a third-party manufacturer to construct a new factory in the City's redevelopment district. The factory is pledged as collateral for the bonds and the bonds are payable from payments received from the manufacturer on an underlying mortgage. If the manufacturer defaults, a request will be made of the City Council to appropriate the amount of the deficiency from the City's resources. The bond documents state that the City may attempt to recover from the manufacturer any payments the City makes due to a default by the manufacturer. At June 30, 20X7, the bonds have an aggregate outstanding principal amount payable of \$19.5 million, none of which was recognized as a liability by the City. The manufacturer is not in default at June 30, 20X7.

The City has not issued other conduit debt obligations to which it extends any additional commitments.

Illustrative Disclosure in the City's Financial Statements

Note K. Conduit Debt Obligations

Conduit Debt Obligations with Limited Commitments

The City has issued education facilities bonds that finance the construction of new buildings by several charter schools. The buildings are pledged as collateral for the bonds. The charter schools are the obligors of the underlying mortgage loans for those buildings. The bonds are payable solely from payments received from the charter schools on those mortgages. In addition, no commitments beyond the collateral, the payments from the charter schools, and maintenance of the tax-exempt status of the conduit debt obligations were extended by the City for any of those bonds. At June 30, 20X7, the bonds have an aggregate outstanding principal amount payable of \$48.5 million.

Conduit Debt Obligations with the City's Appropriation Pledge

To further economic development in the City, the City has issued industrial development bonds to provide capital financing for a third-party manufacturer. Bond proceeds were used by the manufacturer to construct a new factory in the City's redevelopment district. The factory is pledged as collateral for the bonds. The manufacturer is the obligor of the underlying mortgage loan. The bonds are payable solely from payments received from the manufacturer on an underlying mortgage, and the City has committed to maintain the tax-exempt status of the bonds. In addition, if the manufacturer defaults, a request will be made to the City Council to appropriate the amount of the deficiency from the City's own resources, pursuant to a pledge made in accordance with state statute 123.45. If such a payment is made, the City has authority to attempt to recover the amount paid from the manufacturer. At June 30, 20X7, the bonds have an aggregate outstanding principal amount payable of \$19.5 million. The bonds mature in 20Y5.

Example 3—It Is More Likely Than Not That an Issuer Will Make Payments as a Result of an Additional Commitment

Facts and Assumptions

On December 1, 20X1, a State issued \$10 million of 10-year higher education facility bonds that meet the definition of a conduit debt obligation. The proceeds from the bonds were used to finance construction of dormitories of a private college. The bonds mature annually, beginning December 1, 20X2, through December 1, 20Y1, with semiannual interest payments. The dormitories are pledged as collateral for the bonds. There are underlying mortgage loans on those dormitories. The bonds are payable from payments received from the private college on those mortgages. The State made a moral obligation pledge in that if the private college defaults, a request will be made of the State's General Assembly to appropriate the amount of the deficiency from the State's capital reserve fund. There are no arrangements for recovering payments made by the State under this pledge.

In the second half of its fiscal year 20X7, the private college started to encounter financial difficulties. A significant decline of its tuition and dormitory revenue in the fall semester of 20X8 resulted in a violation of revenue coverage requirements contained in the bonds' covenants. The private college made its required June 1, 20X8 interest payment; however, it had to use a significant portion of

the resources in a bond reserve account to do so. The use of those resources brought the balance of the private college's bond reserve account below its required level and constituted another violation of a bond covenant.

Based on the financial difficulties encountered by the private college, the State determined at June 30, 20X8, that it is more likely than not that it will honor its moral obligation pledge and make a request to the General Assembly to appropriate the State's resources and the General Assembly will appropriate resources to replenish the private college's bond reserve account to its required level, thereby supporting the remaining debt service payments. The State determined that the present value of the future outflows of its moral obligation pledge was \$3.05 million at June 30, 20X8.

The State replenished the private college's bond reserve account to its required level on November 28, 20X8, which then was used to make the December 1, 20X8 principal and interest payments. Total payments for the fiscal year ending June 30, 20X9, were equivalent to the debt service payments of the \$1 million in principal and \$175,000 in interest. The State determined that it was more likely than not that it will continue to replenish the private college's bond reserve account so that the remaining debt service payments will be made as scheduled, until the bonds are paid off.

Illustration: Fiscal Years Ending June 30, 20X2, through June 30, 20X7

Accounting for the additional commitment

The State does not record a liability related to its moral obligation pledge extended on the December 20X1 issuance of the conduit debt in the financial statements for the years ending June 30, 20X2–20X7.

Illustrative disclosures: fiscal year ending June 30, 20X2

Note L. Conduit Debt Obligations

In December 20X1, the State issued higher education facilities bonds to provide capital financing for a private college to construct dormitories. The bonds were issued under the authority of the State's Higher Education Financing Act. The dormitories are pledged as collateral for the bonds. There are underlying mortgage loans on those dormitories. The bonds are payable from payments

received from the private college on those mortgages, and the State has committed to maintain the tax-exempt status of the bonds. The State made a moral obligation pledge that if the private college defaults, a request will be made to the State's General Assembly to appropriate the amount of the deficiency from the State's capital reserve fund pursuant to the State's moral obligation pledge. At June 30, 20X2, the conduit debt obligation has an outstanding principal amount payable of \$10 million. The bonds mature on December 1, 20Y1.

Illustration: Fiscal Year Ending June 30, 20X8

Accounting for the additional commitment

In its financial statements prepared using the economic resources measurement focus as of June 30, 20X8, the State records a liability and an expense in the amount of \$3.05 million, the present value of the expected future outflows of its moral obligation pledge.

In its financial statements prepared using the current financial resources measurement focus as of June 30, 20X8, no liability or expenditure is reported.

Illustrative disclosures: fiscal year ending June 30, 20X8

Note L. Conduit Debt Obligations

In December 20X1, the State issued higher education facilities bonds to provide capital financing for a private college to construct dormitories. The bonds were issued under the authority of the State's Higher Education Financing Act. The dormitories are pledged as collateral for the bonds. There are underlying mortgage loans on those dormitories. The bonds are payable from payments received from the private college on those mortgages, and the State has committed to maintain the tax-exempt status of the bonds. The State made a moral obligation pledge that if the private college defaults, a request will be made of the State's General Assembly to appropriate the amount of the deficiency from the State's capital reserve fund pursuant to the State's moral obligation pledge. The bonds mature on December 1, 20Y1.

As a result of the private college's financial difficulties, the State determined that it is more likely than not that it will honor its moral obligation to replenish the private college's bond reserve account to its required level, thereby supporting

the remaining debt service payments. The amount of the State’s liability recognized for its moral obligation pledge is the best estimate of the discounted present value of the future outflows expected to be incurred as a result of this additional commitment.

The liability recognized by the State related to its moral obligation pledge at June 30, 20X8, is as follows:

<u>Beginning of Year</u>	<u>Increases</u>	<u>Decreases</u>	<u>End of Year</u>
\$ 0	\$ 3,050,000	\$ 0	\$ 3,050,000

Illustration: Fiscal Year Ending June 30, 20X9

Accounting for the additional commitment

In its financial statements prepared using the economic resources measurement focus as of June 30, 20X9, the State records a reduction in the liability related to its moral obligation pledge. The reduction includes the payments made by the State to replenish the private college’s bond reserve account that supported the \$1 million of principal payments and \$175,000 of interest payments during that fiscal year. The State also records a \$170,000 increase in the related liability to reflect an increase in the present value of the related liability due to the passage of time.

The State also reports the cumulative payments to replenish the private college’s bond reserve account that supported the principal and interest payments of \$1,175,000 as expenditures in its financial statements prepared using the current financial resources measurement focus.

Illustrative disclosures: fiscal year ending June 30, 20X9

Note L. Conduit Debt Obligations

In December 20X1, the State issued higher education facilities bonds to provide capital financing for a private college to construct dormitories. The bonds were issued under the authority of the State’s Higher Education Financing Act. The dormitories are pledged as collateral for the bonds. There are underlying mortgage loans on those dormitories. The bonds are payable from payments received from the private college on those mortgages, and the State has

committed to maintain the tax-exempt status of the bonds. The State made a moral obligation pledge that if the private college defaults, a request will be made of the State’s General Assembly to appropriate the amount of the deficiency from the State’s capital reserve fund pursuant to the State’s moral obligation pledge. The bonds mature on December 1, 20Y1.

As a result of the private college’s financial difficulties, the State determined that it is more likely than not that it will fulfill its moral obligation pledge to replenish the private college’s bond reserve account to its required level, thereby supporting the remaining debt service payments. The amount of the State’s liability related to its moral obligation pledge is the best estimate of the discounted present value of the future outflows expected to be incurred as a result of this commitment.

On November 28, 20X8, the State began making payments to replenish the private college’s bond reserve account that would support the remaining debt service payments. The cumulative payments through June 30, 20X9, were used to cover the \$1 million in principal and \$175,000 in interest of the debt service payments on the bonds.

The liability recognized by the State related to its moral obligation pledge at June 30, 20X9, is as follows:

<u>Beginning of Year</u>	<u>Increases</u>	<u>Decreases</u>	<u>End of Year</u>
\$ 3,050,000	\$ 170,000	\$ 1,175,000	\$ 2,045,000

Appendix D

CODIFICATION INSTRUCTIONS

Codification of Governmental Accounting and Financial Reporting Standards—December 2020 Update

D1. The instructions that follow update the December 31, 2018 *Codification of Governmental Accounting and Financial Reporting Standards* (Codification), as amended by Statement 87, for the provisions of this Statement. Statement 87 is effective for reporting periods beginning after December 15, 2019. Only the paragraph or footnote number of the Statement is listed if the paragraph or footnote will be cited in full in the Codification.

* * *

[Update cross-references throughout.]

* * *

REPORTING CAPITAL ASSETS

SECTION 1400

See also: [Add the following:] Section C65, “Conduit Debt Obligations”

* * *

REPORTING LIABILITIES

SECTION 1500

Sources: [Remove GASBI 2; add GASBS 91.]

.126 [Replace paragraph .126, including heading, with the following:]

Conduit Debt Obligations

Section C65 provides guidance for issuers of conduit debt obligations. Issuers should recognize liabilities when the criteria in paragraphs .107–.114 of that section are met. [GASBS 91, ¶10–¶17]

[Delete Question .715-1.]

* * *

NOTES TO FINANCIAL STATEMENTS **SECTION 2300**

.106 [In subparagraph (d), replace the parenthetical reference with the following:] (See Section 1500, “Reporting Liabilities,” paragraph .125, Section C50, “Claims and Judgments,” paragraphs .115, .161–.164, .167, and .168, and Section C65, “Conduit Debt Obligations,” paragraphs .121–.123.)

[Revise current paragraph .107z as follows:]

.107 [In subparagraph (z), replace the parenthetical reference with the following:] (See paragraphs .121–.123 of Section C65.)

* * *

CASH FLOWS STATEMENTS **SECTION 2450**

.707-14 [In the question, replace *associated with conduit debt* with *related to a conduit debt obligation*.] [GASBIG 2015-1, Q2.27.1, as amended by GASBS 91, ¶6]

* * *

SEGMENT INFORMATION **SECTION 2500**

[Replace footnote 1 with the following:]

¹Segment reporting is not required when an individual fund both is a segment and is reported as a major fund. [GASBS 34, fn48, as amended by GASBS 91, ¶10]

* * *

Sources: [Add GASBS 91.]

.103 [Replace with the following:] The recognition and measurement of liabilities that arise from breach of contract or similar actions (such as claims for delays or inadequate specifications on contracts), guarantees of the indebtedness of others in an exchange or exchange-like transaction that is not associated with a conduit debt obligation, property tax appeals, and unemployment compensation claims are provided in paragraph .150. [GASBS 10, ¶3, as amended by GASBS 70, ¶4 and GASBS 91, ¶4]

.150 [Replace the fourth sentence with the following:] Those claims include (a) contractual actions, such as claims for delays or inadequate specifications on contracts,¹⁸ (b) guarantees of the indebtedness of others in an exchange or exchange-like transaction that are not associated with a conduit debt transaction and that are not investment derivative instruments entered into primarily for the purpose of obtaining income or profit, (c) property tax appeals, and (d) unemployment compensation claims. [NCGAS 4, ¶9, as amended by GASBS 10, ¶3, GASBS 34, ¶69, GASBS 59, ¶3 and ¶8, GASBS 70, ¶4 and GASBS 91, ¶4; NCGAS 4, ¶14, as amended by GASBS 62, ¶96–¶113]

¹⁸[Insert current footnote 18.]

.153 [Add the following to the end of subparagraph (b):] unless associated with a conduit debt obligation. [GASBS 62, ¶98, as amended by GASBS 70, ¶4 and GASBS 91, ¶4]

.154 [Remove reference to footnote 20 from subparagraph (h); add new subparagraph (i), including footnote, as follows:] Guarantees of indebtedness of others in an exchange or exchange-like transaction associated with a conduit debt obligation.²⁰ [GASBS 62, ¶99, as amended by GASBS 70, ¶4 and GASBS 91, ¶4]

²⁰[Insert current footnote 20 and add the following sentence to the end of the footnote:] The accounting and financial reporting standards for the risks of loss associated with item (i) are provided in Section C65, “Conduit Debt Obligations.” [GASBS 62, fn38; GASBS 70, ¶4; GASBS 91, ¶4]

.164 [Replace *in an exchange or exchange-like transaction* with *in an exchange or exchange-like transaction that is not associated with a conduit debt obligation* and replace *in an exchange transaction* with *in an exchange transaction that is not associated with a conduit debt obligation*] [GASBS 62, ¶109, as amended by GASBS 70, ¶4 and GASBS 91, ¶4]

* * *

CONDUIT DEBT OBLIGATIONS

SECTION C65

Sources: [Remove GASBI 2; add GASBS 91.]

[Replace paragraphs .101–.103, including headings and footnotes, with the following:]

.101–.102 [GASBS 91, ¶3–¶4, including heading]

.103–.123 [GASBS 91, ¶6–¶26, including headings and footnotes]

[Delete Questions .701-2 and .702-1.]

* * *

LEASES

SECTION L20

See also: [Add the following:] Section C65, “Conduit Debt Obligations”

.106 [Replace subparagraph (e) with the following:] Arrangements associated with conduit debt obligations as described in paragraph .115 of Section C65. [GASBS 87, ¶8, as amended by GASBS 91, ¶19 and ¶20]

* * *

NONEXCHANGE FINANCIAL GUARANTEES

SECTION N30

Sources: [Add GASBS 91.]

[Revise current paragraph .102 as follows:]

.102 [Add a new second sentence as follows:] This section also does not apply to governments issuing nonexchange financial guarantees in connection with a conduit debt obligation. [GASBS 70, ¶5, as amended by GASBS 91, ¶4]

* * *

**SALES AND PLEDGES OF RECEIVABLES AND
FUTURE REVENUES AND INTRA-ENTITY
TRANSFERS OF ASSETS AND FUTURE REVENUES**

SECTION S20

See also: [Add the following:] Section C65, “Conduit Debt Obligations”

* * *

SERVICE CONCESSION ARRANGEMENTS

SECTION S30

See also: [Add the following:] Section C65, “Conduit Debt Obligations”

* * *

INVESTMENT POOLS (EXTERNAL)

SECTION In5

.131 [Replace subparagraph (d) with the following:] A conduit debt obligation as described in paragraphs .103–.106 of Section C65, “Conduit Debt Obligations,” should be considered to be issued by the third-party obligor related to the obligation rather than the governmental issuer. [GASBS 79, ¶31, as amended by GASBS 91, ¶6–¶9]

* * *

***Comprehensive Implementation Guide—December
2020 Update***

D2. The instructions that follow update the December 31, 2018 *Comprehensive Implementation Guide* for the provisions of this Statement.

* * *

2.27.1. [In the question, replace *conduit debt* with *a conduit debt obligation*.]
[GASBIG 2015-1, Q2.27.1, as amended by GASBS 91, ¶6]

[Replace Question 7.22.14 with the following:]

7.22.14. [Question number not used]

[Replace Question 7.22.18 with the following:]

7.22.18. [Question number not used]

[Delete Question Z.I2.1 and associated heading.]